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IN THE

Supreme Court of the United States

October Term, 1941.

No. 656.

NORMAN JOHNSON, Suing on Behalf of Himself and All Other Stockholders in THE CURTIS PUBLISHING COMPANY, Similarly Situated Who, Being Interested in the Subject Matter of the Complaint, Shall Become Parties Hereto,

Petitioner,

against

WALTER D. FULLER, MARY L. C. BOK, FRED A. HEALY, CARY W. BOK, BENJAMIN ALLEN, PHILIP S. COLLINS, BRUCE GOULD, PHILIP S. ROSE, WESLEY W. STOUT, LEWIS W. TRAYSER, JOHN B. WILLIAMS, and THE CURTIS PUBLISHING COMPANY,

Respondents.

Brief for Respondents in Opposition to the Petition for Writ of Certiorari.

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IN THE

Supreme Court of the United States.

No. 656. October Term, 1941.

NORMAN JOHNSON, SUING ON BEHALF OF HIMSELF AND ALL OTHER STOCKHOLDERS IN THE CURTIS PUBLISHING COMPANY, SIMILARLY SITUATED WHO, BEING INTERESTED IN THE SUBJECT MATTER OF THE COMPLAINT, SHALL BECOME PARTIES HERETO,

Petitioner,

against

WALTER D. FULLER, MARY L. C. BOK, FRED A. HEALY, CARY W. BOK, BENJAMIN ALLEN, PHILIP S. COLLINS, BRUCE GOULD, PHILIP S. ROSE, WESLEY W. STOUT, LEWIS W. TRAYSER, JOHN B. WILLIAMS, AND THE CURTIS PUBLISHING COMPANY,

Respondents.

BRIEF FOR RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

Opinions of the Courts Below.

The opinion of the District Court is reported in 36 Fed. Supp. 744. The opinion of the Circuit Court of Appeals is reported in 121 F. (2d) 618.

Statement of the Case.

This is an action in equity whereby petitioner, a holder of Respondent Company's Preferred Stock sought, in the alternative, a decree enjoining the payment of dividends

on the Respondent Company's Prior Preferred Stock and interest on its Debentures, so long as any shares of the Company's Preferred Stock remain outstanding, and declaring the issue of the Prior Preferred Stock and Debentures null and void; or a decree requiring the individual Respondents to account to the Respondent Company for the full consideration which, it is alleged, the Respondent Company should have received with respect to the issuance of the Prior Preferred Stock and Debentures (R. *12, 13*).*

The Prior Preferred Stock and Debentures were issued pursuant to a Plan of Reorganization and Recapitalization (hereafter called the Plan) adopted by the stockholders (R. *31*, 1). The Bill of Complaint challenged the validity of the Plan on legal and equitable grounds (R. *11, 12*). Respondents contended that the Plan was valid and equitable, and made the further defense that Petitioner was barred by laches.

The jurisdiction of the District Court was based on diversity of citizenship (R. *3, 19*).

After hearing on the merits, the District Court found the Plan valid and equitable, dismissed the complaint, and entered judgment for the Respondents. The Court held it unnecessary to consider the question of laches (R. *1, 135*).

On appeal, the Circuit Court of Appeals affirmed the judgment of the District Court, likewise without passing on the question of laches (R. 53, 54).

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*References are to pages of that part of the record to be considered on the Petition for Certiorari. References to pages in Appellant's Appendix are printed in italics; those to pages in Appellees' Appendix and other parts of the record in plain type.

Respondents wish to point out an omission of a material fact in Petitioner's "Summary Statement of the Matter Involved". (It should be noted here that Petitioner's ignoring of this important fact infects the Petition and the entire reasoning of Petitioner with a false major premise.) Petitioner avers (Petition, p. 2) that the Plan purported to be effected under Section 801 of the Business Corporation Law of the Commonwealth of Pennsylvania, Act of May 5, 1933, P. L. 364. However, he fails to set forth or mention anywhere in his Petition or Brief the Resolution adopted December 16, 1925 by the stockholders of Respondent Company pursuant to which the Preferred Stock was issued and setting forth its preferences and limitations (R. *20, 26*). These terms were printed in full on the reverse side of each certificate of Preferred Stock, and include the following provision, which supplies the authority for the action taken (R. *20, 27*):

> "So long as any of the Preferred Stock remains outstanding, *the Company will not, without the consent of the holders of two-thirds of the Preferred Stock outstanding, create any mortgage debt or other obligation which would be entitled to payment out of the assets of the corporation prior to the Preferred Stock,* excepting only such obligations as may be incurred in the ordinary and usual course of business, not secured by a lien upon the Company's property, and excepting also purchase money obligations given in connection with the acquisition of new property, *nor shall the Company, without such consent, create any other issue of stock which shall in any way impair the rights of the holders of the present issue of Preferred Stock.*" (Italics supplied.)

Petitioner also makes a misstatement of fact, namely, that under the Plan the Common stockholders received new

Common Stock, share for share (Petition and Brief, pp. 3, 8, 29). Under the Plan, the Common stockholders retained their original shares and suffered a diminution of almost 50% in their common stock equity through the issuance of additional Common Stock to Preferred stockholders who chose to make the exchange (R. *23, 31, 123*).

Respondents represent that the respective findings of the Courts below, as set forth in the Opinions, correctly present the Plan, its authorization and its effect on Preferred and Common stockholders, and also preclude and answer Petitioner's argumentative and one-sided statement of evidence relative to the fairness of the Plan and the good faith of the directors and officers.

Question Presented.

Where preferred stockholders contract that obligations and new issues of stock which impair their rights may be created by 2/3 consent, is a plan of recapitalization, involving the authorization and issue of debentures, prior preferred stock (having priority over the existing preferred stock with unpaid accrued cumulative dividends) and common stock in exchange for existing preferred stock to those wishing to make the exchange, valid where such 2/3 consent is obtained?

SUMMARY OF ARGUMENT.

Respondents contend that (1) no federal question is involved, (2) the question presented is one of purely local law decided in a way not in conflict with local decisions, and (3) the decision of the Circuit Court of Appeals has the support of the judgment of every court which has ever decided the question presented on final hearing.

ARGUMENT.

I. The Case at Bar Presents No Federal Question.

No federal question can be raised under the facts of this case. Petitioner several times asserts by means of rhetorical questions in his Petition for Certiorari that if the Pennsylvania Business Corporation Law authorized the adoption of the Plan that law violates Article I, Section 10 and the Fourteenth Amendment of the Constitution of the United States. A cursory examination of the facts of the case will show that these assertions are hypothetical in fact as well as form.

The Resolution of December 16, 1925 (supra, p. 3), which Petitioner ignores, constitutes the contract between Petitioner, the other stockholders, and Respondent Company. The Plan was adopted pursuant to the express provisions of that Resolution authorizing the creation of obligations and issuance of stock having priority over the Preferred Stock upon consent of two-thirds thereof. The Pennsylvania Business Corporation Law served only to implement the authority granted in the contract by providing the procedure followed in adoption of the Plan. Respondents respectfully submit that action taken pursuant to an express provision of a contract cannot constitute an impairment of that contract or a taking of property without due process of law within the meaning of Article 1, Section 10, or Section 1 of Amendment XIV of the Constitution of the United States.

Respondents' conclusion that the Plan violated no Federal Constitutional right of Petitioner finds authoritative support in a recent decision of this Court, notwithstanding Petitioner's claim (Petition & Brief, pp. 11, 13, 14, 30)

that this Court has never passed upon that issue. The same general Constitutional issues as are here urged were involved in *Kreicker v. Naylor Pipe Co.*, 374 Ill. 364, 29 N. E. (2d) 502 (1940) which upheld a substantially similar plan of recapitalization. An appeal was taken to this Court from that decision. This Court, per curiam (312 U. S. 659), granted a motion to affirm the judgment of the state court on the ground that no Federal Constitutional right was violated.

II. The Decision of the Circuit Court of Appeals Does Not Conflict With Applicable Local Decisions.

Respondents believe that the only question in this case (other than the question of laches which was not decided) is the interpretation of a Pennsylvania contract. No Pennsylvania decisions dealing with a similar contract have been found.

Analysis of *West Chester and Philadelphia R. R. Co. v. Jackson*, 77 Pa. 321 (1875) (cited by Petitioner for the first time in this Court) demonstrates that it is not in point.

Defendant in that case was incorporated by a Special Act of Assembly of 1848. Pursuant to a supplemental Act of Assembly of 1855, defendant issued preferred stock entitled to dividends of 8% per annum before any dividends should be declared or paid in favor of or to any holder of the "unpreferred" stock of the company. At the time of the issuance of this preferred stock only common stock was authorized or outstanding. The Act of 1855 did not reserve in the legislature or in less than 100% of the stockholders the power to issue any other stock which would impair the rights of the holders of the preferred stock. By supplemental Acts of Assembly of 1870 (1871 Pamph-

let Laws) and 1872 the legislature authorized the defendant, with the approval of the holders of a majority of the stock, to issue consolidated preferred stock for retirement and cancellation of *all* stock previously issued, both preferred and common. The consolidated preferred stock was entitled to cumulative dividends of 8% per annum before the holder of any stock thereafter issued or otherwise authorized should receive any dividend. The relationship between this new stock and the old preferred stock was not defined.

Pursuant to this authorization the defendant offered and issued shares of consolidated preferred stock to holders of the preferred stock on the basis of three shares for two and to holders of the common stock on a share for share basis. Thereafter, defendant declared and paid a 4 per cent. dividend on the unexchanged preferred and the consolidated preferred stock. Plaintiff, who had declined to exchange his preferred stock, then claimed that he was entitled to the unpaid cumulative dividends accrued on his preferred stock and sued in assumpsit.

The court held that as against the unexchanged preferred stock (42 shares), the new consolidated preferred stock was common stock, by whatever name called, and that plaintiff was therefore entitled to his full accrued dividends. This conclusion followed from the fact that by paying a dividend on the consolidated preferred which had been issued to the common stockholders the defendant had in fact and in effect paid a dividend to the latter in contravention of preferential rights of the holders of the old preferred stock. In the case at bar, the Plan preserves the contractual preferences of Preferred Stock over Common Stock. The West Chester case is also distinguishable in that there was no reservation of a power to issue addi-

tional stock affecting the rights of holders of the preferred stock.

The only other Pennsylvania case cited by Petitioner is *Petry v. Harwood Electric Co.* (*No. 1*), 280 Pa. 142, 124 Atl. 302 (1924), which is not relevant and is discussed below (p. 10).

III. The Decision of the Circuit Court of Appeals Is Supported by the Judgment of Every Other Court Which Has Decided the Question Involved on Final Hearing.

Respondents take issue with Petitioner's statement (Petition, p. 13) to the effect that the law on the question presented is in a state of confusion, "with conflicting decisions on every side and the rights of investors left to the unguided judgment of each particular judge". Respondents believe that the decision of the Court below has the support of the judgment of every court which has decided this question on final hearing. These decisions follow:

Kreicker v. Naylor Pipe Co., 374 Ill. 364, 29 N. E. (2d) 502 (1940), aff'd 312 U. S. 659 (1941);

Ainsworth v. Southwestern Drug Corporation, 95 Fed. (2d) 172 (C. C. A. 5th, 1938);

Johnson v. Lamprecht, 133 Ohio St. 567, 15 N. E. (2d) 127 (1938);

Shanik v. White Sewing Machine Corp., 19 Atl. (2d) 831 (Del. Sup. Ct., 1941);

Blumenthal v. DiGiorgio Fruit Corp., 30 Cal. App. (2d) 11, 85 Pac. (2d) 580 (1938).

Throughout the proceedings in the case at bar, Petitioner has argued for the application to this case of the results reached in a line of cases, headed by *Keller v. Wilson & Co.*, 190 Atl. 115 (Del. Sup. Ct. 1936), which assert

that preferred stockholders have a "vested right" to accrued cumulative dividends. However, the right protected by these cases may properly be defined as the right of preferred stockholders to have accrued cumulative dividends paid before any dividends are paid on the common stock. The only limitation on corporate action to be found in these cases is a prohibition of charter amendments operating directly on a class of preferred stock so as to wipe out its preferences over common stock with respect to accrued cumulative dividends. Thus, the same courts which have recognized a "vested right" to accrued cumulative dividends have invariably held that plans such as that in the case at bar were valid and did not violate that right, since the preferences of the preferred stock over the common stock were preserved. See *Shanik v. White Sewing Machine Corporation*, 19 Atl. (2d) at pp. 834, 835.

Petitioner argues that the decision in this case conflicts with the principle of *Southern Pacific Co. v. Bogert*, 250 U. S. 483 (1919), and *Jones v. Missouri-Edison Electric Co.*, 144 Fed. 765 (C. C. A. 8th, 1906). (For further proceedings in the Jones case see 199 Fed. 64 and 203 Fed. 945. The denial of certiorari, 229 U. S. 615, cited by Petitioner, applies to the decision in these further proceedings.) These cases establish the principle of corporate law and equity that majority stockholders may not through their voting control impose upon the minority stockholders a transaction or plan which discriminates in the issue of new securities in favor of the majority against the minority. This principle is well settled in the law, but has no application to the case at bar where the Plan, adopted by more than two-thirds of the Preferred Stock voting as a class,

offered exactly the same exchange privileges to all Preferred stockholders.

Lastly, Petitioner argues that the decision in this case conflicts with the principle, enunciated in such cases as *Northern Pacific Ry. Co. v. Boyd*, 228 U. S. 482 (1913), and *Case v. Los Angeles Lumber Products Co. Ltd.*, 308 U. S. 106 (1939), and applied in equity receiverships and bankruptcy reorganizations, which requires the payment in full of senior interests as if on liquidation before junior interests not contributing fresh assets are entitled to recognition. Petitioner also cites *Petry v. Harwood Electric Co. (No. 1)*, 280 Pa. 142, 124 Atl. 302 (1924), involving the rights of dissenting preferred stockholders in a merger which, according to the Pennsylvania Supreme Court, operated as a dissolution insofar as such stockholders were concerned.

The Plan involved no liquidation of the Respondent Company in any sense. It was not, like an equity receivership or bankruptcy reorganization, a substitute for forced liquidation. It did not, like a merger, effect the dissolution of the Respondent Company and thus bring into play the liquidation rights enforced in the Petry case.

In the last analysis, this is a case where stockholders, acting under their contract of association as interpreted by local law, have agreed to a readjustment of their respective rights by a plan of recapitalization which the Circuit Court of Appeals has found fair and validly authorized by their mutual contract and by local law.

Conclusion.

For the above reasons, it is respectfully submitted that the application of the Petitioner for Writ of Certiorari to review the judgment of the Circuit Court of Appeals should be denied.

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